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In the Supreme Court of the United States

OCTOBER TERM, 1978

UNITED STATES OF AMERICA, PETITIONER

v.

ZAC A. CRITTENDEN, JR.,
d/b/a CRITTENDEN TRACTOR COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statement	2
Summary of argument	8
Argument	12
I. The choate lien doctrine should be applied in this case	12
II. The government's lien has priority because it was first in time	13
A. The application of the first in time rule to federal contractual liens is settled law	14
B. There is no sufficient reason to abandon the first in time rule	18
C. The court of appeals' decision in this case illustrates the difficulties in changing priority rules by judicial decision	25
Conclusion	32

CITATIONS

Cases:

Bond v. *Dudley*, 244 Ark. 568, 426 S.W. 2d 780	27
Bryce Hospital Credit Union, Inc. v. *Warrior Dodge, Inc.*, 50 Ala. App. 15, 276 So.2d 602, cert. denied, 290 Ala. 362, 276 So.2d 607	27

Cases—Continued

	Page
Burnet v. *Coronado Oil & Gas Co.*, 285 U.S. 393	26
Checkered Flag Motor Car Co. v. *Grulke*, 209 Va. 427, 164 S.E.2d 660	27
Chicago Title Insurance Co. v. *Sherred Village Associates*, 568 F.2d 217, petition for cert. pending *sub nom. Hercoform Inc.* v. *Chicago Title Insurance Co.* (No. 77-1611)	17, 31
Clearfield Trust Co. v. *United States*, 318 U.S. 363	31
Fitzsimmons v. *Ogden*, 11 U.S. (7 Cranch) 2	14
Freuhauf Corp. v. *Huntington Moving and Storage Co.*, 217 S.E.2d 907	27
Galveston R.R. v. *Cowdrey*, 78 U.S. 459	15, 16, 21
GMC Superior Trucks, Inc. v. *Irving Bank & Trust Co.*, 463 S.W.2d 274	27
Howard v. *Railway Co.*, 101 U.S. 837	14-15
Kimbell Foods, Inc. v. *Republic National Bank*, 557 F.2d 491, cert. granted *sub nom. United States* v. *Kimbell Foods, Inc.*, No. 77-1359 (May 15, 1978)	12
Monell v. *Department of Social Services*, No. 75-1914 (June 6, 1978)	18
Municipal Equipment Co. v. *Butch & Son Deep Rock*, 185 N.W.2d 756	27
National Bank v. *Whitney*, 103 U.S. 99	17
Neslin v. *Wells*, 104 U.S. 428	16
Pennington v. *Alexander*, 103 Ill. App. 2d 145, 242 N.E.2d 788	27
Portneuf-Marsh Co. v. *Brown*, 274 U.S. 630	15

Cases—Continued

	Page
Rankin v. *Scott*, 25 U.S. (12 Wheat.) 177	9, 13, 14, 16
T. H. Rogers Lumber Co. v. *Apel*, 468 F.2d 14	17
Toledo, D. & B. R.R. v. *Hamilton*, 134 U.S. 296	14, 21
United States v. *California-Oregon Plywood, Inc.*, 527 F.2d 687	17
United States v. *City of New Britain*, 347 U.S. 81	12, 15
United States v. *General Douglas MacArthur Senior Village, Inc.*, 470 F.2d 675, cert. denied, 412 U.S. 922	17
United States v. *Hext*, 444 F.2d 804	26
United States v. *Kimbell Foods, Inc.*, cert. granted, No. 77-1359 (May 15, 1978)	8
United States v. *Latrobe Construction Co.*, 246 F.2d 357, cert. denied, 355 U.S. 890	17
United States v. *Pioneer American Insurance Co.*, 374 U.S. 84	13
United States v. *Ringwood Iron Mines, Inc.*, 251 F.2d 145	17
United States v. *Security Trust & Savings Bank*, 340 U.S. 47	12
White Motor Credit Corp. v. *Sapp Bros. Truck Plaza, Inc.*, 197 Neb. 421, 249 N.W.2d 489	27
Willow Creek Lumber Co. v. *Porter County Plumbing & Heating, Inc.*, 572 F.2d 588	17

Statutes and regulations: Page

Bankruptcy Act, 11 U.S.C. 104 14
Consolidated Farm and Rural Development Act, 86 Stat. 657 2
Consolidated Farmers Home Administration Act of 1961, 7 U.S.C. 1921 *et seq.*... 2
7 U.S.C. 1922 2
7 U.S.C. 1929(a) .....
7 U.S.C. 1941(a)(4) 19
7 U.S.C. 1983(a) 19
7 U.S.C. 1983(c), as amended by Pub. L. No. 95-334, Section 123, 92 Stat. 428 19

Federal Tax Lien Act of 1966:
26 U.S.C. 6323 ..... 17, 18
26 U.S.C. 6323(b)(5) 30

28 U.S.C. 1345 4
31 U.S.C. 191 13
Ga. Code Ann.:
§ 109A-9-310 (1973) 27, 28
§ 67-1701(7) (1973) 27
§ 67-2003 (1967) 28
§ 67-2003 (Supp. 1977) 28

Model U.C.C. § 9-310 (1972 ed.) .....*passim*
7 C.F.R. 1801.2(g) 19
7 C.F.R. 1801.3(a)(2) 19

Miscellaneous:
Annotation, 69 A.L.R. 3d 1162 (1976).... 27
3A *W. Collier on Bankruptcy* (14th ed. 1975) 14
2 G. Gilmore, *Security Interests in Personal Property* (1965) 22

Miscellaneous—Continued Page

2 L. Jones, *Chattel Mortgages and Conditional Sales* (6th ed. 1933 and Supp.).. 22
Restatement of Security (1941) 22
1 *J. Story's Equity Jurisprudence* (14th ed. 1918) 14
Whiteside, *Priorities Between Chattel Mortgagee or Conditional Seller and Subsequent Lienors*, 10 Cornell L.Q. 331 (1975) 22

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-36a) is reported at 563 F.2d 678. The opinion of the district court (Pet. App. 40a-41a) is not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 37a) was entered on November 21, 1977. A petition for rehearing was denied on February 6, 1978 (Pet.

App. 39a). On April 28, 1978, Mr. Justice Powell extended the time within which to file a petition for a writ of certiorari to and including July 6, 1978. The petition was filed May 18, 1978, and was granted on October 2, 1978. The jurisdiction of this Court rests on 28 U.S.C. 1245(1).

QUESTION PRESENTED

Whether a private lien that arises after a federal lien had attached may take precedence over the federal lien under principles giving the private lien a form of "super-priority."

STATEMENT

1. In December 1970 Ralph B. Bridges obtained an operating loan from the Farmers Home Administration (FHA) of the United States Department of Agriculture (A. 4-5). The loan was authorized by the Consolidated Farmers Home Administration Act of 1961,[1] 7 U.S.C. 1921 *et seq.*, under which farmers who are "unable to obtain sufficient credit elsewhere to finance their actual needs at reasonable rates and terms" (7 U.S.C. 1922) may obtain federal financial assistance (Pet. App. 3a). To secure this loan, and any additional loans made to him by the FHA, Bridges executed a security agreement granting FHA a security interest in his crops and farm equipment. The FHA perfected this security interest by filing a

[1] The Act has been redesignated the Consolidated Farm and Rural Development Act. See 86 Stat. 657.

financing statement with the appropriate officials in Terrell County and Randolph County, Georgia (A. 5).

The FHA made a second loan to Bridges on August 20, 1971, and a third loan on February 2, 1972 (A. 4, 7). On February 2, 1972, Bridges executed a new security agreement to reflect changes in collateral (A. 5, 7-10). This agreement showed outstanding loans totalling $23,500 in principal amount.[2] It was perfected on February 2, 1972, by filing a financing statement with appropriate Terrell and Randolph County officials (A. 5, 11-12). The collateral listed in the second security agreement included a 1968 Allis Chalmers Diesel 21 tractor, serial number 2417 (A. 5, 8).

More than nine months after the second financing statement was filed, Bridges took his tractor to respondent for repairs and began to accumulate unpaid repair bills (A. 21). By July 1973, Bridges' bill was $1,607.47 (*ibid.*). On December 21, 1973 Bridges again took the tractor to respondent for repairs that raised his account by $543.81, to $2,151.28 (A. 21, 29). Respondent retained possession of the tractor while awaiting payment (A. 29). Respondent did not file a formal lien against the tractor.[3]

On February 4, 1974, Bridges filed a petition in bankruptcy in the United States District Court for the Middle District of Georgia (Pet. App. 4a). On

[2] The agreement listed the August 20, 1971, loan for $1,600 and the February 2, 1972, loan for $21,900 (A. 7).

[3] Compare A. 27-28 (interrogatory 3) with A. 29 (answer 3).

March 14, 1974, respondent foreclosed on his repairman's lien by having the sheriff levy on the tractor (A. 5, 14, 23-24). Respondent remained in possession as bailee (A. 5, 13-14). Bridges was discharged in bankruptcy on September 26, 1974 (Pet. App. 4a).

2. The United States began this action on May 1, 1975, by filing a complaint against respondent to obtain possession of the tractor (see 28 U.S.C. 1345) (A. 4-5).[4] The complaint recited that the United States first learned of respondent's levy when Bridges filed his petition in bankruptcy and the FHA attempted to locate its collateral (A. 5). The complaint contended that the United States was entitled to immediate possession because Bridges had defaulted under the terms of his loan agreement.[5] The complaint also asserted that the United States had an interest in the tractor prior and superior to respondent's, and that the unpaid balance on Bridges' FHA loan account was in excess of the value ($5,000) of the tractor (A. 5-6).

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[4] After the court of appeals' judgment was entered in this case and the case was remanded to the district court, the district court granted a motion for leave to sell the tractor (A. 2). This case therefore will affect the disposition of the proceeds of that sale.

[5] Bridges agreed not to encumber the collateral or permit the collateral to be levied on (A. 9), and he also agreed that failure to observe this agreement would constitute default (A. 10). Bankruptcy of the debtor also constitutes default (*ibid.*).

The district court granted respondent's motion for summary judgment (Pet. App. 40a-41a). It held that the United States did not have a perfected security interest in the tractor because this equipment was not adequately described in the financing statement[6] (*ibid.*). Even if the description were adequate, the court stated, petitioner "nevertheless had a special mechanic's lien against the property which has priority over" the government's interest "regardless of whether 'Georgia' law or 'Federal' law is applied"; alternatively, the court concluded, respondent had an "equitable lien" that the court would acknowledge to prevent "unjust enrichment of [the United States] at the expense of [respondent]" (Pet. App. 41a).

3. The court of appeals affirmed in part. It held that the financing statement's description of the collateral was adequate (Pet. App. 5a-12a), but it concluded that the federal lien was not entitled to priority over respondent's lien for the work done when the tractor was last in respondent's possession (Pet. App. 12a-36a).

The court of appeals acknowledged that federal law governs the rights and liabilities of parties in controversies arising from FHA loan transactions (Pet. App. 12a), but it declined to follow the established federal rule that the lien "first in time is the first in right" (Pet. App. 13a-25a). In so doing, it also rejected the rule that, in order to compete with a federal lien to be first in time, a private lien must

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[6] The financing statement filed with county officials referred to "farm equipment" (A. 11-12).

be "choate" (Pet. App. 13a n.11). The court recognized that respondent's lien could not be first in time under any rationale (Pet. App. 19a n.13) but decided to accord it priority nonetheless, concluding that federal courts should follow the lead of the Federal Tax Lien Act of 1966 in according a "super-priority" to certain repairmen's possessory liens (Pet. App. 15a-22a).[7] It justified this approach as "consistent with accepted commercial principles" in preventing a creditor from "claim[ing] improved personal property at the expense of the repairman" and obtaining "an unfair windfall" (Pet. App. 22a-23a). It also viewed its ruling as protecting " 'the small businessman who operates informally, depending upon an oral agreement and his possession to enforce his claim' " (*ibid.*). It discounted the federal interest because "FHA was engaged in local moneylending transactions" (Pet. App. 25a).

The court of appeals then fashioned a federal rule for this case (Pet. App. 25a-35a). It first considered whether to adopt state law or the Uniform Commercial Code (U.C.C.) as the federal rule. It observed that Georgia law may not accord super-priority to respondent's lien (Pet. App. 26a & n.17). It ultimately selected the U.C.C. rule because the U.C.C.

[7] The court of appeals refers to repairmen's liens for work done on chattels in the repairman's possession as "mechanics' liens" (Pet. App. 13a n.10). We will refer to liens on chattels for repair services as "repairmen's liens" to distinguish them from nonpossessory mechanic's and materialmen's liens for work done and materials furnished on real property.

"embodies rules of nationwide applicability" (Pet. App. 28a-29a), and because the Fifth Circuit previously had said that in fashioning the federal rule for FHA lending programs, it would " 'be guided by the principles set forth in Article 9' " of the U.C.C. (Pet. App. 29a). The court observed that in this case the U.C.C. was more favorable than state law to respondent, and therefore "no reasonable expectation of the mechanic would be thwarted by adopting" the U.C.C. rule (Pet. App. 28a).

The court then proceeded to apply Section 9-310 of the U.C.C. That section provides priority over a perfected security interest to liens for services or materials furnished with respect to goods in the possession of the lienholder, except that the perfected security interest has priority if the lien for services or materials is statutory and the statute expressly provides that the earlier-perfected lien retains priority.[8]

The court followed the U.C.C. in looking to Georgia law to determine whether that State's law recognizes respondent's lien. It determined that the lien is valid under state statutory law and that the U.C.C. therefore gives respondent priority at least for the charges

[8] Section 9-310 of the Model U.C.C. (1972 ed.) provides:

> When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

incurred when the tractor was last in respondent's possession (Pet. App. 31a).[9] The court then turned to the question of the priority of repair charges incurred when the tractor was previously in respondent's possession. Because it was unable to find precedent on this point decided under the U.C.C., the court turned to the provision of the Federal Tax Lien Act; it concluded, on the authority of that Act's treatment of possessory liens, that respondent's claim for earlier repairs is junior to the federal lien (Pet. App. 23a-35a).

SUMMARY OF ARGUMENT

I

The choate lien doctrine should be applied to federal contractual liens for the reasons set forth in our brief in *United States* v. *Kimbell Foods, Inc.*, cert. granted, No. 77-1359 (May 15, 1978). If the doctrine is applied in this case, the government's lien has priority. Bridges' tractor was not delivered to respondent for repairs until nine months after the government's lien was recorded, and therefore respondent's lien could not have been choate when the government's lien was perfected by filing. If the Court agrees with our arguments in *Kimbell*, then it should reverse the judgment in this case.

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[9] The court decided that it would not follow the exception contained in Section 9-310 providing that the perfected security interest will nonetheless have priority if state statutory law so provides. Pet. App. 31a-32a n.20.

II

A. The court of appeals also rejected a more fundamental doctrine in refusing to recognize that the lien first in time is first in right. The choateness rule was developed to determine whether federal or private liens are first in time. But the underlying doctrine, that the lien first in time is first in right, is the fundamental common law rule. This Court has characterized it as a "principle * * * believed to be universal" (*Rankin* v. *Scott*, 25 U.S. (12 Wheat.) 177, 179 (1827)) and has applied it to establish priorities between federal and private liens, as well as among private lienholders.

Application of the rule allows a lender to assess his risks. The Court has regarded it as a matter of fundamental fairness to the prior lienholder who expects, in the absence of a contrary statute or agreement among the affected parties, that each successive interest will be subject to all prior interests. Although Congress undoubtedly could alter this long-established rule, alterations of this type, which affect the business expectations of the commercial community, are properly a subject of legislative rather than judicial action. The court of appeals' reasons for undertaking a judicial revision are insufficient.

B. The first two reasons given by the court of appeals—that the policies of the Federal Tax Lien Act of 1966 support abandoning the established rule as to federal contractual liens, and that the federal government should be treated just like any other commercial lender—were advanced by the court in *Kim-*

bell as well. But, as we stated in our brief in that case, Congress simply did not address the policies affecting federal contractual liens when it legislated with respect to tax liens. Moreover, the federal government, as a lender of last resort, cannot be characterized as merely another commercial lender.

The court of appeals also relied on its conclusion that a repairman's lien is special and that it is unfair for the first lienor to have priority over it. But the first in time rule does not mean that the repairman is without protection. He or the debtor may ask the secured party to release some of the collateral, or the repairman can require the debtor to advance the funds for repairs or provide some other security for work done on credit.

Further, the treatment of repairmen under the first in time doctrine is not so different from the treatment of other creditors in position of equal equity. The mere fact that the repairman possesses the tractor should not distinguish him from the grocer who provides food, or supplier who provides seed. Each contributes to the operation of the farm, increases the prospects of the FHA regaining the funds it has loaned, and thus benefits the FHA. No one has suggested that these suppliers should have a super-priority on this basis. Indeed, this Court has rejected similar arguments by improvers or conservers of property claiming a super-priority for their liens.

The American Law Institute and a number of commentators agree that the equities do not require a super-priority for repairmen; the applicable Restate-

ment adopts the rule that the secured interest retains priority unless the secured creditor agrees to subordinate his interest. And a number of states continue to follow this rule.

C. The first in time rule has the virtue of certainty and simplicity. The Fifth Circuit's course in developing a new common law, by contrast, is idiosyncratic and unpredictable. In reaching its result in this case, it borrowed from state law, the Model U.C.C. and the Tax Lien Act. No similar rule can be found in any statute or principle of common law, and no one can predict what the result will be in another case with slightly different facts. The FHA and the other lending agencies of the United States have no idea what rule will be applied to future cases.

Our point is not that the Fifth Circuit's formulation is worse than any other reformulation, but that there is no suitable body of law, other than the first in time doctrine, from which the courts can draw a uniform rule. Only the first in time rule can be administered in an efficient and equitable way, in the absence of additional guidance from Congress. The appropriate body to modify that rule is the Congress.

ARGUMENT

I

THE CHOATE LIEN DOCTRINE SHOULD BE APPLIED IN THIS CASE

As the court of appeals recognized (Pet. App. 13a n.11), if the choate lien doctrine—which requires a private lien to be choate before it can complete with a federal lien for priority—applies to this case, then the government's lien has priority. Bridges' tractor was not delivered to respondent for repairs until nine months after the government's lien was recorded, so "the identity of the lienor, the property subject to the lien, and the amount of the lien" (*United States* v. *City of New Britain*, 347 U.S. 81, 84 (1954); see also *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 50-51 (1950)) could not have been established, and respondent's lien could not have been choate, at the time the government's lien was perfected by filing.

The court of appeals stated that it did not apply the choateness doctrine here because it had held, in *Kimbell Foods, Inc.* v. *Republic National Bank*, 557 F.2d 491 (5th Cir. 1977), cert. granted *sub nom. United States* v. *Kimbell Foods, Inc.*, No. 77-1359 (May 15, 1978), that the doctrine should be abandoned. We have argued in *Kimbell* that the choateness rule should be retained. The arguments we have made there also show that the choate lien doctrine should be applied to this case.[10] The government's lien accordingly should have been accorded priority.[11] If the Court agrees with our arguments in *Kimbell*, then it should reverse the judgment in this case.

[10] We are supplying respondent with a copy of our brief in *Kimbell*.

II

THE GOVERNMENT'S LIEN HAS PRIORITY BECAUSE IT WAS FIRST IN TIME

The court of appeals in this case rejected a more fundamental doctrine, of which the choate lien rule is only an application. It refused to recognize that the lien first in time is first in right. This Court originally derived the choateness doctrine from the implementation of the first-in-time rule in the insolvency statute, 31 U.S.C. 191; the choateness doctrine was employed to determine which liens are first in time.[12] The underlying doctrine—that the lien first in time is first in right—is a rule of general applicability that this Court characterized as the fundamental common law rule. See, *e.g.*, *United States* v. *Pioneer American Insurance Co.*, 374 U.S. 84, 87 (1963); *Rankin* v. *Scott*, 25 U.S. (12 Wheat.) 177, 179 (1827). Even if this Court should hold in *Kimbell Foods* that the choate lien doctrine should not be applied to contractual liens, it should continue to enforce the funda-

[11] The court of appeals recognized that "if the choateness doctrine applies here, FHA's security interest would be superior to Crittenden's lien" (Pet. App. 14a n.11).

[12] We discussed the development of the choate lien doctrine at pages 17-21 of our brief in *Kimbell*.

mental precept that the lien first in time is first in right.[13]

A. The application of the first in time rule to federal contractual liens is settled law

In 1827, when this Court decided *Rankin* v. *Scott*, *supra*, a case involving the relative priority of two private judgment liens, the first in time rule was already a settled principle of law. As Mr. Chief Justice Marshall observed, "[t]he principle is believed to be universal that a prior [valid] lien gives a prior claim, which is entitled to prior satisfaction out of the subject it binds." [14] 25 U.S. (12 Wheat.) at 179. The rule has been followed, at common law, ever since.[15] When this Court addressed the issue of tax

[13] The relative priorities of the government and respondent were not affected by Bridges' bankruptcy. Assets of the bankrupt in the trustee's hands are subject to liens in favor of third persons at the date of bankruptcy, and priority rights given by the Bankruptcy Act (11 U.S.C. 104) do not affect valid liens. See 3A *W. Collier on Bankruptcy* § 64.02[2] & n.10 (14th ed. 1975). The insolvency statute, 31 U.S.C. 191, also had no application at the time the government brought this action, because Bridges' discharge in bankruptcy rendered him solvent once again.

[14] The rule, expressed as the maxim *qui prior est in tempore, potior est in jure*, was applied in equity as well as at law. *Fitzsimmons* v. *Ogden*, 11 U.S. (7 Cranch) 2, 17 (1812) (dictum); *Toledo, D. & B. R.R.* v. *Hamilton*, 134 U.S. 296, 298-301 (1890); 1 *J. Story's Equity Jurisprudence* § 68 (14th ed. 1918).

[15] See, *e.g.*, *Toledo, D. & B. R.R.* v. *Hamilton*, 134 U.S. 296, 298-301 (1890) (giving recorded mortgage on railroad lands that was prior in time priority over mechanic's lien for work done in constructing the railroad); *Howard* v. *Railway Co.*,

lien priorities in 1954 in *United States* v. *City of New Britain*, *supra*, 347 U.S. at 85-86, it applied the first in time doctrine, reasoning that "[w]e think Congress had this cardinal rule in mind" because it had not enacted any different schedule of priorities for tax liens. The Court quoted *Rankin* with approval and observed that the first in time rule still "is widely accepted and applied in the absence of legislation to the contrary." In *United States* v. *Pioneer American Insurance Co.*, *supra*, 374 U.S. at 87, the Court again characterized the first in time doctrine as "the common-law rule," applying it to determine the priority of a federal tax lien.

Application of the first in time rule allows a lender to assess his risks. Only prior liens can be known with certainty, and if subsequent liens could achieve priority the certainty necessary in money transactions would be undermined. Subsequent lenders can discover existing interests and, if they seek a priority higher than that provided by the first in time rule, can negotiate with existing secured parties. The rule never prevents consensual orderings of priorities; it simply sets a starting point from which bargaining

101 U.S. 837, 844-849 (1879) (as between two judgment liens, giving priority to lien based on earlier entered judgment); *Galveston R.R.* v. *Cowdrey*, 78 U.S. (11 Wall.) 459, 475, 476, 480-482 (1870) (denying priority to mechanic who claimed priority over earlier mortgages by virtue of benefits conferred on railroad). See also *Portneuf-Marsh Co.* v. *Brown*, 274 U.S. 630, 636-640 (1927) (noting that "[u]sually liens prior in time are prior in equity" but concluding that statutes established priority in that case).

can proceed. And because it sets a clear starting point, the first in time rule holds to a minimum the costs associated with bargaining and with the resolution of disputes about lien priorities.

This Court also has regarded the rule as a matter of fundamental fairness to the prior lienholder. In the absence of a statute reordering priorities, the lienholder expects that subsequent lienors will obtain only so much of an interest as remains in the debtor to convey or encumber. Each successive interest is assumed to be taken subject to all prior interests, and upsetting this expectation would "work the greatest injustice." *Galveston R.R.* v. *Cowdrey*, 78 U.S. (11 Wall.) 459, 475-476 (1870). See also, *e.g.*, *Neslin* v. *Wells*, 104 U.S. 428, 440 (1881); *Rankin* v. *Scott*, *supra*, 25 U.S. (12 Wheat.) at 178.

The rule has been followed for so long that expectations—indeed, entire systems of lending—have been built on it. Congress undoubtedly could alter the first in time rule, as the states have modified it in some respects by adopting the Uniform Commercial Code. But alterations of this sort, we submit, are properly a subject of legislative rather than judicial action. The reasons advanced by the court of appeals are insufficient to justify judicial revision of a centuries-old rule. "Judicial decisions affecting the business interests of the country should not be disturbed except for the most cogent reasons, certainly not because of subsequent doubts as to their soundness. The prosperity of the commercial community depends, in a great degree, upon the stability of the rules by

which its transactions are governed." *National Bank* v. *Whitney*, 103 U.S. 99, 102 (1880).

Not only the decisions of this Court but also those of the great majority of the courts of appeals [16] recognize the application of the first in time rule to federal contractual liens. The showing that can justify judicial alterations of established rules—a demonstration that the rule was a misunderstanding of

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[16] Since enactment of the Tax Lien Act, 26 U.S.C. 6323, the courts of appeals for the First, Second, Seventh and Tenth Circuits have rejected the argument that the Tax Lien Act has any bearing on the priority of federal non-tax liens and have continued to apply the first in time doctrine in conjunction with the choateness doctrine. *Chicago Title Insurance Co.* v. *Sherred Village Associates*, 568 F.2d 217 (1st Cir. 1978), petition for cert. pending *sub nom. Hercoform, Inc.* v. *Chicago Title Insurance Co.* (No. 77-1611); *United States* v. *General Douglas MacArthur Senior Village, Inc.*, 470 F.2d 675 (2d Cir. 1972), cert. denied, 412 U.S. 922 (1973); *Willow Creek Lumber Co.* v. *Porter County Plumbing & Heating, Inc.*, 572 F.2d 588 (7th Cir. 1978); *T. H. Rogers Lumber Co.* v. *Apel*, 468 F.2d 14 (10th Cir. 1972).

Of these cases, *MacArthur Senior Village* directly involved a claim of super-priority, and the Second Circuit refused to accord the non-federal lien the super-priority conferred by state law and recognized by the Tax Lien Statute. It thus followed the earlier refusal of the Third and Eighth Circuits, in cases antedating the Tax Lien Act, to recognize super-priorities over federal contractual liens. See *United States* v. *Ringwood Iron Mines, Inc.*, 251 F.2d 145 (3d Cir. 1958); *United States* v. *Latrobe Construction Co.*, 246 F.2d 357 (8th Cir.), cert. denied, 355 U.S. 890 (1957). *Chicago Title* also involved a claim of extraordinary priority based on state mechanics' lien rules.

But see *United States* v. *California-Oregon Plywood, Inc.*, 527 F.2d 687 (9th Cir. 1975) (according super-priority to state tax liens).

congressional intent, a departure from prior practice, and not the subject of reliance (see *Monell* v. *Department of Social Services*, No. 75-1914 (June 6, 1978), slip op. 35-41)—has not been made here, for the first in time rule has been regarded by common consent as the common law rule and relied on in thousands, perhaps millions, of federal loans.

B. There is no sufficient reason to abandon the first in time rule

The court of appeals advanced three reasons for abandoning the first in time rule. It argued that Congress had altered the rule for tax liens and that the courts should follow that lead for contractual liens (Pet. App. 19a-22a); it contended that application of the first in time rule to a repairman who had improved the value of the property would be unfair (*id.* at 22a-24a); and it concluded that the government should be treated in the same way as private lenders, who now are subject to state laws modifying the first in time rule (*id.* at 25a). None of these reasons is adequate to justify judicial alteration of a rule so firmly established as the first in time doctrine.

The court of appeals' principal argument is based on the Federal Tax Lien Act of 1966, 26 U.S.C. 6323, which the court thought established rules (or at least set a pattern) to be followed in non-tax cases. We have addressed this argument at pages 26-32 and 47-49 of our brief in *Kimbell Foods*. We also addressed, at pages 21-25 and 41-44 of that brief, the court of appeals' argument that the federal government should be treated just like any commercial lender. The same considerations apply in this case, and we rely on them here.[17]

The new argument in this case is the court of appeals' conclusion that repairmen's liens are special, and that it would be unfair for the first lienor to have priority over the subsequent repairmen's lien (Pet. App. 22a-24a). In the court's words (*id.* at 22a-23a; footnote omitted):

> The prior secured creditor's interests are not prejudiced by granting the [repairman's] lien

[17] The FHA, like the agency involved in *Kimbell* (the SBA), makes high-risk loans for reasons of governmental policy, rather than for considerations of profit. FHA loans are available only to farm families unable to obtain credit from other sources at reasonable rates. 7 U.S.C. 1941(a)(4), 1983(a). See 7 C.F.R. 1801.2(g), 1801.3(a)(2). If at any time the borrower is able to obtain a loan from another responsible credit source at reasonable rates and terms, the borrower must "graduate" to this other credit source. 7 U.S.C. 1983(c), as amended by Pub.L. No. 95-334, Section 123, 92 Stat. 428. In other words, the FHA is not an ordinary moneylender. The FHA makes loans from a revolving fund (7 U.S.C. 1929(a)), so that any decrease in the recoveries on its loans either reduces the supply of credit or requires Congress to replenish the fund out of tax receipts. The FHA has experienced serious losses, so that any reduction in the priority accorded to its loans may have a substantial effect on the public fisc. (As of June 30, 1978, the FHA had outstanding operating loans exceeding $1.4 billion. Of these, 17,772 loans worth more than $315 million were delinquent. The Department of Agriculture has other individual farm loan programs in which funds are available only on a showing of special need; 20,723 loans from these funds, totalling more than $1 billion, were delinquent on June 30. The total delinquencies on that date for all special need farm loan programs of the Department under the Consolidated Farm and Rural Development Act were $1,334,561,000.)

> super-priority status because the value of the secured party's collateral is usually enhanced by at least the amount of the lien. * * * Thus in the case at bar FHA should be in the same position after Crittenden's lien attached as it was prior to Crittenden's labors. To allow a creditor to claim improved personal property at the expense of the repairman's interest in such a situation would grant the creditor an unfair windfall.

The court apparently concluded that the first in time rule necessarily is unfair to repairmen. This argument is open to question for several reasons.

a. The first in time rule does not mean that the first lienor has an unchangeable primacy. As the court of appeals recognized, a repairman who desires the greater security available from a more senior lien can "check[] the records and then request[] a release from the FHA and other parties." Pet. App. 35a n. 23. If the FHA were convinced that the repairs would improve the value of the collateral by more than the cost of the repairs, it might release some of the collateral. The first in time rule does no more than ensure that the decision to release or not release "properly rests with the secured party" (*ibid.*). The security agreement in this case, in which the debtor agreed to keep the collateral "free from all liens, encumbrances, security or other interests" except existing liens and landlord's statutory liens (A. 9), represents an attempt to preserve the decision in the hands of the secured party. The court of appeals' approach, on the other hand, transfers effective decision-making

power from the secured party to the debtor and persons who contract with the debtor.

If the first in time rule is applied, repairmen could approach the secured party to seek a partial interest in the collateral sufficient to protect the value of the proposed work. Repairmen could, instead, require debtors to advance the funds for the repairs or to provide other security for work done on credit.[18] Debtors also could approach the secured party, seeking an alteration in the security agreement to give priority to the repairman; the repairman then would perform the repairs on credit secured by the collateral. So long as the repairs increase the value of the collateral, it should be possible to arrange such changes in the security agreements. This is the path that the Court traditionally has required subsequent lienors, including repairmen, to follow if they desire priority over a secured creditor. See *Galveston R.R.* v. *Cowdrey, supra*, 78 U.S. (11 Wall.) at 480-482; *Toledo, D. & B. R.R.* v. *Hamilton*, 134 U.S. 296, 298-301 (1890).[19]

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[18] Payment in advance should not be unduly burdensome for commercial debtors. If the repairs in fact increase the value of the collateral, then the debtors could obtain additional loans with which to pay for the cost of repairs. The security agreement in this case permitted the debtor to ask the FHA to advance funds "for the preservation or protection of the collateral" (A. 9); the advances would be added to the indebtedness on the note at the same rate of interest.

[19] The court of appeals relied on the U.C.C. to show that super-priority for repairmen's liens is the accepted modern rule. The U.C.C. shows nothing of the sort. Section 9-310 of the Model U.C.C. is simply a rule that applies when other state statutes are silent; the draftsmen of the Code did not expect

b. The court of appeals focused on questions of equity between the repairman and the secured party. For the reasons just given, we submit that the first in time rule does not raise the problem that the court perceived. But however that may be, it is pertinent to ask about equitable treatment of similarly situated subsequent lenders. Many people advance funds to debtors. Respondent provided the debtor with some $2,000 in repair work over the course of a year. A grocer or seed supplier might provide the debtor and his family with $2,000 in food or supplies during the same period. Under what standard of equity is the junior claim of a repairman to be preferred over that of the FHA, but the equally junior claim of the grocer or supplier to be treated as inferior? Certainly, in weighing equities, the mere fact that a repairman possesses the tractor while working on it

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Section 9-310 to replace all other rules of priority, and, as the First Circuit explained in *Chicago Title Insurance Co., supra,* the Code did not do so. Rules for the priority of repairmen's and mechanics' liens vary dramatically from state to state; in Georgia, in which the FHA's security agreement was filed, the security interest apparently has priority over repairmen's liens. See note 24, *infra.* Pertinent treatises also express disagreement about the appropriate treatment of repairmen's liens. See, *e.g.,* 2 L. Jones, *Chattel Mortgages and Conditional Sales* §§ 478a-478b (6th ed. 1933 and Supp.); 3 *id.* at § 1126; 2 G. Gilmore, *Security Interests in Personal Property* § 33.3 (1965); Whiteside, *Priorities Between Chattel Mortgagee or Conditional Seller and Subsequent Lienors,* 10 Cornell L.Q. 331, 335-337 (1925). The American Law Institute favors the rule that the secured creditor retains priority over a repairman unless the secured creditor agrees to subordinate his interest. *Restatement of Security* § 76 (1941).

is not a sufficient reason to prefer him over the grocer; the fact that collateral comes into the hands of repairmen but not the grocer's is simply a function of how they provide a service to the debtor.[20]

The court of appeals might respond to this argument by pointing out that the repairman improves the value of the collateral, whereas the grocer does not, and that the repairman's security interest comes out of the value of the improvement. This "new" collateral can be assigned to the repairman, the court might reason, without impairing in any way the position of the secured party.

But this contention, too, seizes on the fortuity that the benefit to the collateral can be traced directly. Suppose that a debtor borrows $2,000 from a bank to pay a repairman. The bank would not be able to claim priority over the FHA, even though the tractor still would have increased in value because of the repairs. Or suppose that the debtor, with $2,000 cash on hand, pays a repairman for repairs but neglects an older bill due to the grocer. The grocer—left out of the arrangement—would have no claim against the tractor. The fact that the debtor in this case paid his grocer rather than his repairman should not affect the extent of security of the FHA.

Many people advance funds without which the debtor loses his livelihood and thus defaults on his loan. Grocers, seed merchants, farm machinery deal-

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[20] While the repairman has a statutory lien and the grocer does not, this difference would not appear significant in the court of appeals' broad consideration of the equities here.

ers, repairmen, and many other merchants may advance goods on credit. All of these merchants contribute to the operation of a debtor's farm. All of these contributions are necessary to the prospect of repayment; after all, the FHA relies principally on the success of the debtor's farm business as a source of repayment and looks to the collateral only in extremis. Under the "equity" rationale of the court of appeals, each of these merchants could claim priority over the FHA, because each contributes something that makes the debtor's payment more likely, and hence inures to the benefit of the FHA. But this approach would turn the law of secured transactions on its head, making the most junior loans the "most important" and hence the ones to be paid first.[21] If, as we think clear, the grocer and seed merchant are not entitled to priority on such a rationale, then the court of appeals' arguments from "equity" are reduced to special pleading on behalf of subsequent creditors who happen to make a peculiarly visible contribution to the FHA's likelihood of recovering on its loans. We submit that a desire to reward one class of creditors whose contributions happen to be visible is not a sufficient reason for a court to upset a rule of priority followed since the founding of the Nation.

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[21] This Court has previously rejected claims that it should reverse the order of priority to favor subsequent improvers (or conservers) of property. See *Galveston R.R.* v. *Cowdrey, supra; Toledo, D. & B. R.R.* v. *Hamilton, supra.*

c. The court of appeals' decision also misunderstands the nature of the risk taken by a secured lender. Repairs are not a sort of windfall improvement in the value of collateral. Repairs are an everyday occurrence. The secured lender takes the risk that the collateral will break down and become worthless; the secured lender also assumes the ordinary risks of wear and tear. The value of collateral such as a tractor gradually diminishes over time. Repairs simply retard the rate at which the value decreases. Far from being windfalls to secured creditors, repairs are essential in controlling the rate at which the value of the collateral is reduced. The court of appeals' decision changes the nature of the secured party's risk, however, by exposing the secured party to all of the erosion in value caused by wear and tear, while giving the secured party little benefit from the repairs that are part of the debtor's obligation.[22]

C. The court of appeals' decision in this case illustrates the difficulties in changing priority rule by judicial decision

Whatever its drawbacks, the first in time rule has one undoubted virtue: certainty. It is simple to understand and, once the identities and dates of the competing liens have been established, easy to administer. Because in questions concerning contractual

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[22] In this case the debtor agreed to "care for and maintain the collateral in a good and husbandlike manner" and "not [to] permit the collateral to be levied upon, injured or destroyed, or its value to be impaired" (A. 9).

dealings "it is more important that [the matter] be settled than that it be settled right" (*Burnet* v. *Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting))—the parties can rearrange priorities by contract, and the legislature can alter undesirable rules—it is important that any newly-devised judicial rule not cause a decrease in the certainty of the law and the ease of its administration.

We argued at pages 44-51 of our brief in *Kimbell Foods* that the course on which the Fifth Circuit has embarked will produce substantial uncertainty, and that only a legislative solution to questions of priority among competing liens offers the prospect of producing a certain and easily administrable rule. We offered the Fifth Circuit's opinion in the instant case as an example of the idiosyncratic and unpredictable nature of the evolving priority doctrine (*Kimbell Foods* Br. at 46 n.52). We expand on that discussion here.

The Fifth Circuit had indicated in earlier cases that it would use the U.C.C. as a model for devising rules of federal law in cases involving FHA loans. *United States* v. *Hext*, 444 F.2d 804, 810-811 (5th Cir. 1971). In this case, however, after deciding to abandon the first in time rule, the court did not turn directly to the U.C.C. Indeed, it could not do so. Section 9-310 of the Model U.C.C., the only arguably relevant portion of the Code, does not contain a complete priority rule; the U.C.C. instead refers the

reader back to state law.[23] Moreover, Georgia has not adopted the Model U.C.C. provision on this point.[24]

The court therefore first examined state law rather than the U.C.C. It concluded, however, that it would not follow state law here because that law probably would lead to a judgment in favor of the secured creditor,[25] and the court concluded that it should adopt

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[23] See note 8, *supra*, for text of Section 9-310 of the Model U.C.C. (1972 ed.).

[24] Ga. Code Ann. § 109A-9-310 (1973) provides that "a preferred security interest in collateral takes priority over each and all of the liens * * * described in section[] 67-1701 * * *," with certain exceptions not relevant here. Section 67-1701(7) describes, among other things, a "lien[] in favor of mechanics on real and personal property." This apparently gives the secured creditor priority over repairmen's liens.

A number of other state statutes expressly provide that earlier perfected security interests have priority over repair liens, and they have been held to apply in lieu of Section 9-310. See, *e.g.*, *Bryce Hospital Credit Union, Inc.* v. *Warrior Dodge, Inc.*, 50 Ala. App. 15, 276 So. 2d 602, cert. denied, 290 Ala. 362, 276 So. 2d 607 (1973); *Bond* v. *Dudley*, 244 Ark. 568, 426 S.W. 2d 780 (1968) (vendor of automobile retains priority); *Pennington* v. *Alexander*, 103 Ill. App. 2d 145, 242 N.E. 2d 788 (1968); *Municipal Equipment Co.* v. *Butch & Son Deep Rock*, 185 N.W. 2d 756 (Iowa 1971); *White Motor Credit Corp.* v. *Sapp Bros. Truck Plaza, Inc.*, 197 Neb. 421, 249 N.W. 2d 489 (1977); *GMC Superior Trucks, Inc.* v. *Irving Bank & Trust Co.*, 463 S.W. 2d 274 (Tex. Civ. App. 1971); *Checkered Flag Motor Car Co.* v. *Grulke*, 209 Va. 427, 164 S.E. 2d 660 (1968) (only first $75 of repair lien has priority); *Freuhauf Corp.* v. *Huntington Moving and Storage Co.*, 217 S.E. 2d 907 (W. Va. 1975). See also Annotation, 69 A.L.R. 3d 1162, 1177-1180 (1976).

[25] See note 24, *supra*. The court of appeals considered Georgia law to be unclear (see Pet. App. 26a n.17) because, in enacting Section 109A-9-310, the state legislature had not

a rule of law more favorable to the repairman (Pet. App. 27a-28a). The court suggested that it would follow whichever available law—state law, the U.C.C., or some other principle—is most favorable to repairmen (*ibid.*).

This decision required the court to return to Section 9-310 of the Model U.C.C. as a possible source of federal law.[26] Because Section 9-310 does not apply unless the repairman has a lien otherwise valid under state law, the court of appeals then looked back to state law to determine whether respondent had a repairmen's lien. Applying state law, it found that respondent had a lien (Pet. App. 31a).

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repealed an inconsistent provision contained in Ga. Code Ann. § 67-2003 (1967), and because it later reenacted the inconsistent provision with amendments (see Ga. Code Ann. § 67-2003 (Supp. 1977)). But Section 67-2003 was replaced (albeit implicitly) by Section 109A-9-310; the reenactment of Section 67-2003 simply added a provision about storage liens that is irrelevant to repairmen's lien questions.

[26] The court argued that "application of Uniform Commercial Code principles [in this case] ensures that the rights and duties of the FHA will be substantially the same as those of other lenders, and thus the reliance of third parties on state commercial rules will no longer be frustrated merely because a government lender enters the scene." Pet. App. 29a (footnote omitted). This statement makes no sense here, for the court of appeals admittedly is applying, under the U.C.C., rules different from those that would have prevailed under Georgia law. Respondent—the "third party" in this case—could not reasonably have relied on the Model U.C.C. in making his repairs. His only point of reference would have been state law or the first in time rule, and the court's decision to apply the Model U.C.C. to this transaction must have surprised respondent as much as it surprised the United States.

Having followed the U.C.C. this far, the court abandoned it once more. The last part of Section 9-310 refers to state law a second time for the purpose of determining whether some other state statute provides for a priority in the secured creditor rather than in the repairman (see note 8, *supra*). Recognizing that Georgia law, which Section 9-310 would apply here, probably gives priority to the FHA (see notes 24 and 25, *supra*), the court refused to follow the U.C.C.'s second reference to state law (Pet. App. 29a n.19, 32a n.20.). It selected, once more, whatever available rule was most favorable to repairmen; here, it concluded, the most favorable rule is the U.C.C. provision shorn of the final "unless" clause.[27]

It then became necessary to construe the portion of the U.C.C.—a portion the court of appeals adopted—giving the repairmen's lien priority when that lien is "upon goods in the possession of" the repairman. This

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[27] The court stated (Pet. App. 31a n.20) that respondent would be entitled to super-priority even if it were to give effect to the "unless" clause of Section 9-310. This is so, it stated, because the state statutes to which the "unless" clause refers include only the statutes *creating* the repairmen's lien. Here, because one statute creates the lien and a separate state statute makes that lien subordinate to a prior security interest, the court of appeals concluded that the U.C.C. would give respondent's lien priority. We submit that this approach is hair-splitting without redeeming virtue; the evident purpose of the U.C.C. is to follow any "explicit" state law subordinating the repairmen's lien to a prior security interest. Georgia law contains such a subordination rule; indeed, the subordination rule is placed in Georgia's version of the U.C.C (see note 24, *supra*).

part of the U.C.C. raised difficulties because, although the tractor was in respondent's possession at the time of the suit, it had been in and out of respondent's possession while the repairs were being made. The Model U.C.C. offered no clue about the priority of liens for repairs when the possession was discontinuous.

The court of appeals therefore departed from the U.C.C. for a third time and incorporated the "possession" requirement of the Tax Lien Act, which does contain a rule for dealing with multiple, successive episodes of possession. The Tax Lien Act gives priority to a repairman's lienor only to the extent that lienor has been in "continuous[]" possession of the chattel "from the time such lien arose" (26 U.S.C. 6323(b)(5)). Here respondent had been in "continuous" possession of the tractor only during and after the last repairs, which were billed at $543.81. The court of appeals therefore gave respondent priority over the government to the extent of $543.81, and the government retained its security interest in the remaining value of the tractor (Pet. App. 33a-35a).

No one could have predicted this result. The court selected snippets of state law, the Model U.C.C., and the Tax Lien Act in formulating a hybrid rule. No similar rule can be found in any statute or principle of the common law. No one could predict what rule would be applied tomorrow to a slightly different form of lien, because that lien might exist under slightly different provisions of Georgia law that the court of appeals might incorporate in place of the Tax Lien

Act or the U.C.C. And the rule in Maine might be completely different. See *Chicago Title Insurance Co.* v. *Sherred Village Associates*, 568 F.2d 217 (1st Cir. 1978), petition for cert. pending *sub nom. Hercoform, Inc.* v. *Chicago Title Insurance Co.*, No. 77-1611. It is not overstating the matter to say that, so long as an analysis similar to that used by the court of appeals prevails, the FHA, and the other lending agencies of the United States, can have no idea what rule of priority will be applied to their security interests.

Our point is not that the court of appeals' formulation of a new federal rule is inferior to some other possible formulation. It is, rather, that there is no model rule, applicable to situations like the present one, on which courts can draw. The U.C.C. is not a suitable model because it incorporates state laws, and because different states have different versions of the U.C.C. State law is not suitable because incorporation of particular state laws contradicts the hypothesis, from which the court of appeals started, that there should be a uniform rule applicable to all federal liens throughout the Nation. Pet. App. 12a. See generally *Clearfield Trust Co.* v. *United States*, 318 U.S. 363, 367 (1943). And the Tax Lien Act does not supply a satisfactory answer not only because—as we have argued in *Kimbell Foods*—Congress did not intend to apply the principles of that statute beyond tax cases, but also because it attempts to set up a special set of rules to deal with involuntary federal liens. Here, by contrast, the federal lien was created by contract. We submit, in sum, that

only the first in time rule can be administered in an efficient and equitable way by the courts in the absence of additional guidance from Congress. It may be that the first in time rule should be modified in some respects, but the appropriate body for that task is the legislature.

CONCLUSION

The judgment of the court of appeals, to the extent it awards respondent priority, should be reversed.

Respectfully submitted.

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